entire day, he or she will cause the same load to the PSTN as an Internet user.

C. The Explosive Internet Growth ILECs Predict May Be Affected By Many Factors.

Much of the ILECs' discussion of the costs of Internet traffic focuses on their predictions that Internet use will grow dramatically in the near future. For example, US West projects that the number of ISP lines in use will double by 2001. US West Comments at 16. Southwestern Bell, seemingly assuming that the number of ISP lines will remain constant, predicts that the length of time per call will increase from two to four times by 2001. Southwestern Bell Comments at 10. Taking a third approach, PacTel simply predicts a doubling in the number of users by 2001. PacTel Comments at 9-10.

While they diverge widely in the type of growth they predict, one feature these estimates share is that they assume an explosive growth which is quite uncertain. There are two flawed premises to their predictions: that the Internet will grow exponentially and that all data traffic will remain on the PSTN. As the FCC's Office of Plans and Policy has noted, "the Internet's growth rate has actually been quite stable for some time...." OPP Working Paper at 16. Future Internet growth may be affected, positively or negatively, by issues of full, equal access; advancing technology; intellectual property; international trade; commercial transactions; security of communications; and user privacy. *See also, Id.* at 7. At a minimum, this means that these commenters cannot predict with reasonable certainty that the growth will outstrip the development of more efficient transport technologies. Moreover, it means that the Commission should refrain from heaping more uncertainty and volatility on this mercurial industry.

D. The ILECs Grossly Underestimate Their Revenue Derived From Internet Use.

Many ILECs' base their proposals to impose access charges on ISPs on a claim that their costs from Internet traffic outweigh revenues. They have claimed that, despite terminating significant traffic, ISPs pay only low, business rates for access lines. *See, e.g.*, BA/NYNEX Comments at 7; US West Comments at 15.

These commenters continue to focus only on half the picture, excluding the considerable revenue generated from Internet users. This revenue, namely second line installation costs, monthly fees, and use-based fees where applicable, cannot be ignored; it is traceable to the very same Internet traffic that ILECs allege causes net costs. Moreover, ILECs have avoided straight-forward revenue estimates, even when they do address user revenues.

1. A Large Proportion Of Second Lines Are Purchased For Internet Use.

Bell Atlantic attempts to dismiss second line revenue as bearing little relation to Internet users. BA/NYNEX Comments at 11. It suggests that there are many other reasons for growth of second lines, and that lines for other family members or home office users account for two-thirds the total second line use. *Id.*

This assertion overstates the circumstances. To be sure, some users purchase second lines for the additional reasons Bell Atlantic suggests. But in other fora, Bell Atlantic has acknowledged that this growth is fueled by the Internet. In its most recent quarterly sales report, it plainly states that "[s]ales of secondary residential telephone lines, propelled by continued growth in the use of home computers..." reached record levels. *Id.* A September, 1996 statement by James G. Cullen, Bell Atlantic's President, stated, "A large percentage of secondary lines are used for dial-up access via personal computers." James G. Cullen, "The Mass Market for Data

Connectivity: A Giant Awakens" at 3 (downloaded from http://www.bell-atl.com/invest/news/stat-updt/v1_i2_96.htm) ("Cullen Statement").

Indeed, it is apparent that the Internet is the true engine driving the dynamic growth of second line sales. By Bell Atlantic's own reckoning, the sales of second residential lines in its territory has increased by almost 20% over the previous year, to almost a quarter of a million lines sold in the first quarter of 1997. "Bell Atlantic Reports First Quarter Net Income Up 11.0 Percent" at 2 (downloaded from http://www.bell-atl.com/html/today) ("BA 1st Quarter 1997 Report"). Of the phenomena Bell Atlantic claims drive this sales growth, only the Internet, and clearly not the number of teenagers, has increased at such a pace.

2. Second Line Revenues Result In Net Profits And Are Driving Earnings Growth.

Several ILECs suggest that they receive little profit on second lines. PacTel, for example, notes that a large part of its monthly revenue on flat-rate residential lines[12] comes from usage charges (*e.g.* toll and interexchange access fees) and value-added features (*e.g.* call waiting), revenue which is not generated from dial-up use. PacTel Comments at 32. Southwestern Bell and GTE concur, and add that second residence lines "in most cases do not even cover the costs of the line." Southwestern Bell Comments at 11; GTE Comments at 24-25.

This makes little intuitive sense, however. First, ILECs have heavily advertised second

[12]It should also be noted that a significant percentage of dial-up users are held by business accounts. These users do pay use-based fees, and therefore contribute to ILEC revenues. Even by PacTel's reckoning, 20% of dial up Internet users in its territory use business lines, not residential. This is a significant source of revenue, which is strikingly absent from the ILECs' studies, even though the traffic generated by these users is presumably included in their cost estimates.

lines, and have featured appeals directed specifically to Internet users. *See, e.g.*, "Special Offers: Pacific Bell Spring Additional Line" (downloaded from http://www.pacbell.com/ideas-of-fers/offers/offer-add-line.html). Bell Atlantic admits, "in 1995, when the Internet phenomenon came into full bloom...we intensified our promotion of secondary residential lines, achieving gross sales of well over a half million units." Cullen Statement at 3. It has stated that one of its "key initiative[s]" is to "[i]ncrease penetration of additional lines through promotions and advertising." "Network Services: Lines of Business Profiles" at 2-3 (downloaded from http://ww-w.bell-atl.com/invest/businvpr/netserv/consumer.htm) ("BA Lines of Business Profiles"). It is illogical to think that ILECs would encourage purchase of a service which caused them to lose money.

Moreover, these arguments do not comport with ILEC's statements to Wall Street and the press that second lines are propelling earnings growth. For example, in its most recent quarterly earnings report, Bell Atlantic stated that it hopes to sell an total of one million additional residential lines in 1997 alone. BA 1st Quarter 1997 Report at 2. In a 1996 shareholders release, it also stated:

> A top priority of the network business in 1996 will be achievement of a five percent revenue growth target...We will continue to promote sales of secondary residential lines, targeting more than 600,000 additional lines in 1996...[and] between three and four million secondary lines in service by the end of the century, which would represent a penetration of 30 to 35 percent of the residential market.

Network Services: Strategic Overview at 2-3 (downloaded from http://www.bell-atl.com/invest/businvpr/netserv/overview.htm); Cullen Statement at 3; BA Lines of Business Profiles at 2. Similarly, in a newsletter directed at the financial community, PacTel's President of Consumer Communications Services reported:

> We're driving growth by focusing on specific applications that stimulate network usage in the consumer market. Later this year we'll launch the third in a series of promotions to customers who need an additional telephone line...

Pacific Telesis Inside Line at 2 (downloaded from http://www.pactel.com/financial/inside_line/il93.html). In its 1995 annual report, US West told investors, "Today's customers need additional lines....We foresee continued growth in sales - and income - as we meet those needs in the years ahead." Statement of Richard D. McCormick, Chairman and CEO, US West, Inc., "US West Investor Info" (downloaded from http://www.uswest.com/aboutusw/investorinfo/annuals/annual95/presidents.html).

3. Some ILECs Have Overstated The Costs Incurred In Placing Second Lines In Service.

PacTel and GTE argue that they incur significant cost to make second residential lines operational. PacTel claims, without factual support, that about 35% of additional line requests require it to install new facilities. PacTel Comments at 33. Similarly, GTE observes that activation of a second line requires placing new plant in service, may require line cards and additional end office switches, and means that one additional line is unavailable for use as a primary service for someone else. GTE Comments at 25.

As PacTel's statement acknowledges, in the majority of cases, the plant for additional lines is already in place. Even assuming arguendo the validity of PacTel's estimate, for fully 65% of second line orders, it collects a windfall because it does not need to install new plant, but ***it charges the same installation fee*** to all customers. Apparently, none of this cost savings

gets passed on to users.[13]

Moreover, the argument that strong second line sales will force ILECs to install more switches and interoffice facilities makes the groundless presumption that ILECs will not recover these costs as part of their fees for new installations. GTE's claim seems to be that more lines in service reduces its revenue. This is as erroneous as a merchant saying that a strong season of sales is ruining the business, because there will be associated costs to replenish inventory.

III. THE COMMISSION'S TREATMENT OF ISPS IS CORRECT AS A MATTER OF REGULATORY POLICY, AND DOES NOT CAUSE AN IMPLICIT SUBSIDY OR DISCRIMINATE AMONG USERS.

Many commenters supporting the imposition of access charges level various attacks at the regulatory classification of ISPs. They allege that the decision not to impose fees was to apply temporarily only while the industry was in its infancy, that it represents an implicit subsidy to ISPs, and that it discriminates against interexchange carriers and other parties who pay access charges. To reach these conclusions, however, these parties misconstrue the nature of Internet use and Commission precedent.

A. The Commission Is Still Correct In Refraining From Imposing Disruptive Regulatory Fees On An Already Volatile Industry.

Several ILEC commenters argue that the decision not to impose access charges on ISPs was a transitional provision designed for an infant industry. *See, e.g.*, Comments of the Telecommunications Resellers Association at 8-10 ("TRA Comments"); BA/NYNEX Comments at 2-4; PacTel Comments at 13. They conclude, therefore, that in light of the rapid growth of

[13]In fact, ILECs realize cost savings from additional lines which increase their profit from monthly fees, such as efficiencies in servicing, billing, and accounting.

Internet use over the last few years, this rationale should no longer apply. TRA Comments at 11; AT&T Comments at 3, 11.

As explained in IUCs comments, this misinterprets Commission precedent. IUC Comments at 19-21. Far from conferring a regulatory benefit to one industry, the Commission stated that it was abstaining from imposing a regulatory cost. Its original decisions were based on an equitable desire to encourage development of this new industry and to avoid the regulatory drag that would result from imposition of these fees. Furthermore, it expressly stated that its purpose was to avoid increasing the volatility of an already changing market.

More importantly, when considered as a communications and commercial medium, the "developing industry" designation applies with more weight today than ever. The Internet is still an "infant" - both in terms of where the technology can go, and how it can empower speech, commerce, research, education, and democracy. The recent development of new services and capabilities, especially World Wide Web services such as search engines, java, and streaming audio and video, are evidence of an ever-developing sophistication and potential. As the Commission has seen, however, new charges would have a disruptive effect on Internet users, the ISP industry, and hardware and software manufacturers. The Commission should refrain from making the imprudent move of saddling this evolving medium with burdensome new regulation and fees.

B. Claims That Failure To Impose Charges Would Be A Subsidy Of ISPs Are Based On Misstatements Of Internet Cost Causation And Revenue.

Starting from the flawed premise that Internet use causes ILECs to suffer a net loss in revenues, several commenters reach the even more flawed conclusion that if ISPs are not

subjected to new, use-based fees, it would amount to an implicit subsidy from PSTN users to ISPs. *E.g.*, US West Comments at 11, 18-19; BA/NYNEX Comments at 10. US West argues, for example, that "[t]o the extent that ESP usage puts disproportionate usage demands on LECs' switches and the costs incurred by LECs in accommodating that extra usage, other users are in effect subsidizing ESP usage." US West Comments at 18-19.

This is untrue; ISP traffic imposes far less additional cost than ILECs have estimated. As noted above, at 18, and in IUC's comments, at 26-27, most Internet traffic makes efficient use of off-peak capacity and therefore causes far less cost than ILECs assume. Most ILECs, however, simply avoid acknowledging the off-peak nature of this traffic.

GTE does attempt to estimate its costs from peak-hour traffic. GTE Comments, Attachment A. This study still distorts the picture, however. Most notably, it fails to compare its estimated costs to any reasonable estimates of revenue from Internet traffic. *Id.* During peak hour, from 4:00 p.m. to 5:00 p.m., a large proportion of dial up users will be businesses. These users pay higher, use-sensitive rates. PacTel Comments at 32; *see* above, note 12.

Actually, it is ***ISP access charges*** that would be a subsidy, since it is doubtful that Internet use causes a net cost. Under one scenario, fees paid by Internet users would flow to support the ILECs' investments in overlay data-carrying capacity. Alternatively, the fees would flow to nothing but ILEC general profits.[14] Moreover, since they would give them a competitive

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[14]That the ILECs have not offered to neutralize any windfall received by their ISP units is merely proof of their real intentions to profit at Internet users' expense. One way to neutralize this competitive advantage, for example, would be for ILECs to set aside a sum equal to the amount of the internal transfer from their ISP business units to the parent corporations. This set aside amount could then be earmarked as an additional contribution to Universal Service fund, over and above the amounts the ILECs would already contribute.

advantage in the Internet services market, user fees would subsidize the ILEC's ISP business unit ventures.

C. The Commission Is Not Discriminating In Favor Of ISPs Because Internet Traffic Shows Few Functional Differences From Other PSTN Traffic.

Some commenters argue that because the Commission does not impose use-based charges, it discriminates in favor of ISPs over similarly situated users of the PSTN. TRA Comments at 4-5; Comments of TCA, Inc. at 2, 4. For example, TCA, Inc. says that ISP use parallels use of the local exchange because it is not the end of the path that data must travel. TCA Comments at 4. PacTel and GTE say that without the imposition of new charges, the Commission will be treating ISPs differently from other users who impose costs on the PSTN. PacTel Comments at 24, GTE Comments at 30.

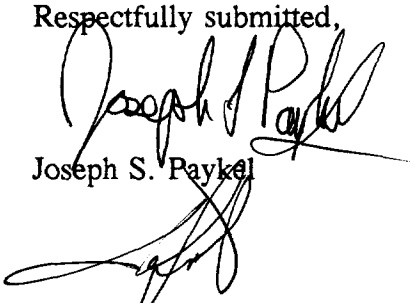
This rationale is inadequate to justify imposing additional costs on ISPs. Indeed, many other end users terminate PSTN traffic, convert it to certain protocols, and send data far beyond their point of presence. Ticket agencies, financial services and stockbrokers, and catalog sales lines might route calls to central computer or perform protocol conversion. Similarly, PBXs on university campuses or corporate campuses might route traffic through and between large buildings, even over private lines to other cities.

It makes little difference that ISPs impose some cost on the PSTN, because the ILECs collect more than compensatory revenue from Internet users. Clearly, every user of the network causes some incremental usage cost, if some percentage of their calls occur during the peak hour. The use by ISPs is no different, but the ILECs seek to add new time-based fees on them; ***this*** would be discrimination.

CONCLUSION

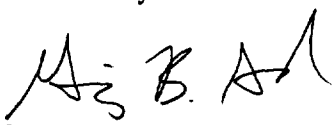
The importance of the user perspective to this debate cannot be overstated. The IUC urges the Commission to bear in mind that the Internet brings much social benefit, that users have already created strong demand for high-bandwidth data networks, and that revenues derived from Internet users significantly compensate the ILECs for costs to the PSTN. Seen in this light, the proposals to impose new use-based fees are fatally flawed and the Commission should reject them.

Respectfully submitted,



Joseph S. Paykel

Andrew Jay Schwartzman



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